ISAMI – Building a Microfinance Industry for the West Bank and Gaza

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Palestinian Network for Small and Micro Finance – Microfinance Fact Sheets (English Version)

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THE PALESTINIAN NETWORK for small and micro finance

Fact Sheet 1 Understanding Microfinance and its Contribution to Economic Growth

What is Microfinance?

Microfinance is a powerful economic development tool. Its unique approach to poverty alleviation targets the working poor, a segment of society that is typically underserved by conventional economic development strategy. Microfinance programs deliver basic financial services to the vast numbers of business owners with little or no access to the credit, deposit, and savings mechanisms offered through commercial banks.

Why is Microfinance Important?

In the West Bank and Gaza Strip, 95 percent of all business establishments are classified as microenterprises. Building a Palestinian microfinance industry will help harness the economic potential of these many thousands of small businesses and channel it into a greater contribution to GDP.

In addition, many microfinance programs throughout the world have proven to be profitable service areas for commercial lending institutions. Microfinance programs benefit the working poor, who lack access to needed capital and to traditional sources of credit. Microfinance can raise living standards, provide jobs, reduce dependence on foreign aid and contribute to stable and sustained economic growth.

What is a Microenterprise?

Microenterprise is a term used by economic development experts to describe a small business operation that generates subsistence income for the owner and, in some cases, a very small number of employees.

Who are Microentrepreneurs?

Microentrepreneurs are the owners of small-scale business operations described above that provide just enough income to cover basic household expenses, such as food, clothing and shelter. Microentrepreneurs are the principal beneficiaries of microfinance programs.

What is the Difference between a Microenterprise and a Small Business?

Development literature occasionally draws a distinction between "micro" and "small" businesses according to the number of employees. These definitions are not always useful in a distressed economic environment like the West Bank and Gaza Strip, where most small business owners face the same restricted access to credit and savings mechanisms as microentrepreneurs. Traditionally, commercial lending policies make little distinction between the two types of enterprises. Lending decisions are usually based on a business owner's credit history and ability to offer loan collateral.

What are the Key Components of a Microfinance Program?

Source: World Bank, Making Microfinance Work in the Middle East and North Africa, 1999

- Short-term credit instruments
- Quick and easy procedures for obtaining credit
- Access to repeat loans for borrowers with a good repayment history
- Mobile branches and other means of reaching rural borrowers
- Programs for targeted microfinance groups, such as women

Are Microfinance Programs Always Successful?

Not always. For this reason, The Palestinian Network for Small and Micro Finance places the highest priority on the widespread dissemination of best practices information, gained from its years of experience managing microfinance initiatives throughout the world. It also offers technical assistance in order to support the development of a microfinance industry in the West Bank and Gaza Strip using tested and proven methods for success.

How Can Microfinance Become Both Profitable and Sustainable?

Development experts have collected a wealth of data from microfinance practitioners throughout the world. From that data, a pattern of microfinance best practices has emerged.

- Cover costs
- Avoid government and donor subsidies
- Promote outreach
- Tailor services to meet borrower needs
- Demonstrate focus and commitment to program goals

It takes time and dedicated resources to build microfinance activity to a level that positively impacts the local economy. But experience demonstrates that well planned and carefully implemented microfinance programs are capable of achieving that goal.

Numbers to Remember

95% of all business establishments in the West Bank and Gaza Strip are microenterprises

500 million of the world's economically active poor people run profitable microenterprises

Current microfinance efforts in the West Bank and Gaza Strip reach only **23%** of potential borrowers

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Fact Sheet 2

Microfinance Best Practices - Tips for Lenders

Many different approaches to microfinance have been applied in developing economies throughout the world. Experienced microfinance practitioners agree that the successful delivery of financial services to the working poor requires the systematic application of best practices. A policy of rigorous adherence to best practices makes it easy for lenders to incorporate the successful strategies of other institutions and to avoid commonly made mistakes.

What are Microfinance Best Practices for Lenders?

Best practice application occurs at three institutional levels: management, operations and customer relations. Strategies must be tailored to suit the local environment, however, effective programs all share a number of common characteristics.

Management Best Practices

Commit to the Provision of Microfinance Services

Successful programs are committed at the highest levels of management to the delivery of financial services to the entrepreneurial poor and to micro and small business owners who lack access to traditional sources of capital. Formulate a microfinance operations business plan and dedicate the financial and human resources needed for implementation and maintenance.

Maximize Efficiency of Microlending Operations

Profitable microlending operations require streamlined, low-cost procedures. Develop rapid and accurate loan approval, funds disbursement and collection methods for maximum efficiency.

Cover Costs

Know the direct and indirect costs of each component of your microfinance program. The interest rates and loan fees of sustainable programs recover their operating costs.

Assess Market Demand

Lending rates and application fees must allow total cost recovery, but the cost of borrowing cannot exceed what local clients can afford to pay. Conduct market analysis surveys to determine the balance between cost recovery and market demand.

Train Loan Officers

Educate your loan officers on microfinance best practices and operating procedures. Specialized staff training in microfinance operations is essential.

Network with other Microfinance Programs in the Region

Communicate regularly with regional microfinance partners through practitioner forums and associations. Program innovations, effective techniques and client referrals often result from the ongoing exchange of information among regional lenders.

Participate in Studies, Seminars and Workshops

Local and regional microfinance forums often sponsor education and outreach events. Conferences, courses and seminars provide valuable information and networking opportunities for loan officers and program staff.

Operations Best Practices

Recruit Local Loan Officers from Community

Recruit local loan officers from the target community to expedite monitoring activity and to establish a local presence for the lending institution that is well connected to the community. Social ties are an important factor in the guaranteeing repayment of microfinance loans.

Extensive Geographical Coverage

Having extensive geographical coverage especially in remote areas, through the provision of mobile branches serves as an important time saver for borrowers; borrowers do not have to take time from the workday to visit main branches, and loan officers can efficiently conduct community outreach services and monitor borrowers' operations.

Utilize Information Technology

Internet, fax and wireless technology play an important role in connecting remote communities to banking services. Microfinance lenders can exchange information and access borrowers' credit histories as that data is collected and becomes available through a central credit bureau.

Customer Relations Best Practices

Create Community Awareness of Microfinance Programs

Generate borrower interest and educate the community as to the purpose and potential of microfinance through targeted publicity campaigns. Distribute Arabic language flyers and brochures. Sponsor outreach events together with local community organizations to enhance local awareness of microfinance services.

Separate Microfinance Activity from Social Welfare Programs

Pay careful attention to the separation of microfinance program activity from charitable or social welfare programs. Promote the long-term economic goals of microfinance and educate borrowers on its potential contribution to sustainable community growth. Reinforce the concept of microfinance as a business tool rather than a welfare program.

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Fact Sheet 3 Problem Loan Management

Every Microfinance provider faces the challenge of managing problem loans. Large or small, short or long term, all loan delinquencies threaten portfolio integrity and the profitability of lending operations. Loan delinquencies can be caused by a multitude of factors. Effective portfolio managers establish strategies for spotting and handling problem loans before the first missed payment.

In the West Bank and Gaza Strip, political uncertainty creates significant economic stress for borrowers and lenders alike. The temptation exists for banks to restrict or suspend microlending operations in an adverse economic climate. Short-term credit restriction may alleviate short-term losses, but lenders should also consider potential long-term implications such as a reduction in client base and erosion of lending capital.

Microfinance practitioners advocate taking a proactive lending approach in a difficult economic environment. Banks who work with good customers to reach solutions in trying times are more likely to retain a strong client base for future business.

Problem Loans: Understanding the Big Picture

What is My Role as a Loan Officer?

- Loan officers play three critical roles:

Portfolio Manager. Each loan officer is responsible for ensuring the quality of his/her loan portfolio, for minimizing costs and maximizing income, and for reaching groups targeted by the lender's microfinance program.

Loan Monitor. Loan officers must carefully monitor, analyze and report all portfolio activity for problem loans as well as loans in good standing.

Workout Specialist. When loans do go bad, the loan officer works with the client to get repayments back on track as rapidly as possible.

What are the Costs of Problem Loans?

- A bad loan has many hidden costs:

Time wasted collecting past-due receivables

Time taken away from developing new business

Head office, regional and branch managers' time wasted in addressing delinquency issues

The Domino Effect: Other borrowers will lose motivation to pay on time

Loss of loan program reputation

Strategies for Dealing with Problem Loans

How Can I Avoid Problem Loans from the Outset?

Screen Out Unsuitable Borrowers or Bad Business Ideas

Obtain Character References

Assess Borrower's Ability to Manage Project

Document Available Collateral Sources

Match the Size of the Loan with Repayment Abilities

Ensure Sufficient Cash Flow

Use Incentives or Disincentives to Pay the Loan on Time

Communicate "Zero Tolerance for Late Payments" Philosophy to Borrowers

How Do I Effectively Monitor the Loans in My Portfolio?

Establish and adhere to a schedule of frequent monitoring and collections visits

Let the borrower know what information he is expected to have available for every visit

Use a Monitoring Schedule Form to collect relevant data

Compare reality with your projections

Ask additional probing questions

Watch for warning signs (any indication that funds have been put to improper use)

Monitor particular risks for loan by checking production, sales and receivables levels, inventory levels and construction progress

Keep your manager informed of potential problems

Communicate concerns to the borrower before warning signs turn into actual problems

What Kind of Information Should I Monitor?

Sales trends

Overall cash flow compared to projections

Any major purchase

Sums in or out of the business

Increase in receivables or inventory

What Should I Do When the Borrower Misses a Payment?

Immediately inform your manager when the first payment is missed

Ensure the borrower understands that the lending institution will never stop trying to collect the receivable

Enlist support for collection efforts from community and relatives

Inform guarantors of loan delinquency and engage them in collection efforts

Send formal legal communication to borrower documenting delinquent loan status

Schedule time for more frequent monitoring visits to delinquent accounts

Use management approved restructuring and workout techniques to get loans back on track

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Fact Sheet 4 Effective Loan Monitoring and Information Management

Why is Monitoring So Important in Microfinance?

Microloans are often monitored with greater frequency and attention to detail than long-term loans for much larger amounts. Many skilled loan officers who are new to the field of microlending sometimes find this situation counterintuitive. Why spend so much time monitoring small loans? The reasons are quite straightforward.

Microfinance differs from conventional business lending in several ways:

Microloans are commonly made to business owners operating in highly volatile, sometimes distressed economic and political conditions, such as the West Bank and Gaza Strip. Loan officers who visit clients weekly are monitoring environments in which changes can come swiftly and can only be properly assessed first-hand. Site visits accomplish a number of important tasks:

- Impressing upon the borrower the seriousness of his loan commitment
- Staying abreast of changes in the local environment (neighborhood)
- Observing any lapses in good management practices
- Watching for signs of any misuse of loan proceeds
- Noting any changes in the behavior of the borrower towards the loan officer
- Collecting important data relevant to the financial health of the business

Microentrepreneurs are often unfamiliar with the principles of commercial finance. As a result, the loan officer should sit with the borrower to explain the importance of abiding by the terms of the loan contract. The borrower should be aware that timely repayment builds a good credit history, Building a good credit history guarantees that the borrower will be eligible for future loans that will finance the development and expansion of his/her business.

Frequent monitoring visits help to emphasize these important concepts for the borrower. Effective loan officers also take the time to explain that loan proceeds are reinvested in new microloans throughout the community. Consequently, one client's failure to pay directly impacts the MFI's ability to extend loans to others in need. Emphasizing the role microfinance plays in building a strong business community reinforces program sustainability.

A microfinance institution must work to establish its presence, its purpose, and its commitment to the growth of the local business community. Community outreach plays a large part in institutional sustainability. Loan officers often use monitoring visits to call upon other potential clients in the neighborhood, or to post informational flyers within the community.

In microfinance, loan monitoring is a unique business development opportunity. Trained loan officers are program ambassadors for the MFI. Frequent site visits raise the visibility of the microfinance program within the local community, while allowing the loan officer to collect important data on the loans in his or her portfolio.

How Do I Keep Track of the Information Collected on Each Visit?

Information collected on site visits must be carefully recorded in writing. Loan officers use Monitoring Scheduling Forms to keep track of the dates and the purpose of each site visit. A more detailed Loan Monitoring Report provides a handy checklist to ensure that all relevant data is being collected.

Each MFI develops customized monitoring forms for its own use. But the samples below provide an idea of what the forms look like and the information they contain.

Microfinance Lending Program

Monitoring Scheduling Form

Client Name: ____________________

Frequency of Visits: ____________________

Loan Duration: ____________________

Loan Purpose: ____________________

Loan Officer: ____________________

Date of Visit	Purpose of Visit	Loan Status: OK/Watch/Problem

Loan Monitoring Report

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Fact Sheet 5

Risk Management and the Credit Risk Grading System (CRGS)

Microfinance Lending and Risk Management

Lending is a risk management business. All loans have associated risks that depend on the type of the loan, the character of the borrower, the business and the market environment. Experienced microfinance practitioners use a variety of risk management tools in their day-to-day operations, tailored to the lending environment in which they operate.

Risk Management Tools

Microfinance institutions need to actively minimize risk at every stage of the lending process, from pre-approval to final payoff of the loan. Credit officers must be rigorously trained in the techniques that help them accurately assess risk factors throughout the lifetime of the loan. ***Fact Sheet Three: Problem Loans*** in this series provides sample checklists for effective borrower assessment and diligent monitoring practices. These checklists are risk management tools which help identify potentially high risk clients and the early warning signs that a loan may be in trouble. Let's look at another valuable risk management tool: The Credit Risk Grading System.

What is the Credit Risk Grading System?

The Credit Risk Grading System (CRGS) is utilized by well-managed lending institutions worldwide. By using the CRGS, loan officers assign numerical risk grades to the individual loans in their portfolios. Risk grading is performed at regular intervals (at least monthly), under management supervision. The CRGS takes into account not only a borrower's repayment history, but environmental and personal factors affecting the loan as well.

Why is Credit Risk Grading So Important for Microfinance Institutions?

Lending is a risk management business. All loans have associated risks that depend on the type of the loan, the character of the borrower, the business and the market environment. Experienced microfinance practitioners use a variety of risk management tools in their day-to-day operations, tailored to the lending environment in which they operate. Simply stated, the CRGS system provides a "snapshot" of the financial health of a loan officer's portfolio. A portfolio with a large number of high risk loans is in trouble, and also indicates that the loan officer's risk management skills may be inadequate. At the institutional level, more than one or two portfolios with high risk levels are a warning that the entire microfinance lending operation might be in jeopardy.

How Are Risk Grades Assigned?

Loan officers use the data collected during monitoring visits, as well as their knowledge of prevailing market conditions, to assign risk grades to loans in their portfolios. Low numbers are associated with low risk levels; higher numbers represent a loan in delinquency or a loan headed for trouble. Risk grades are defined by management. They should be appropriate to characteristics and conditions of the specific lending environment, and once established, they should not subject to frequent change. A sample Risk Grade chart follows.

Risk Grades

General Risk	Credit Risk Grade	Description
Low Risk	Grade 1 - Excellent Grade 2 - Good Grade 3 - Satisfactory	Loans that develop according to the projections or better, and no problems with repayment have ever occurred or are anticipated.
Potential Risk	Grade 4 - Watch List	Loans that show deviations from the projected business development scenario and problems with repayments can be anticipated.
High Risk	Grade 5 - Substandard Grade 6 - Doubtful Grade 7 - Loss	Loans with different terms of delinquency, they are associated with different probabilities of being fully repaid. The longer a loan is delinquent, the less likely it is that its balance would be repaid in full.

Source: Shorebank Advisory Services, USA, Credit Risk Grading System Module.

What Factors are used in the Credit Risk Grading System?

Loan officers using the CRGS regularly evaluate a wide range of environmental and personal factors that can impact the borrower's ability to repay a loan. The CRGS trains loan officers to remain alert to changing market conditions and to carefully observe borrower behavior patterns that may precede a loan falling into delinquency. In these cases, prompt action often helps to avert trouble before it starts.

Some environmental factors include:

- Competition
- Relationships with suppliers and customers
- Product market
- Growth potential of the business
- Overall growth potential of the industry

Personal factors are specific to the borrower, and they include, but are not limited to:

- Level of management expertise
- Prior credit history and repayment rate
- Length of time in business
- Quality of relationship with the loan officer

Can Risk Ever Be Completely Eliminated From the Lending Equation?

No. In the real world, unforeseen circumstances can occur, especially in areas of relative economic and political instability, like the West Bank and Gaza Strip. Addressing these challenges effectively is simply a part of doing business.

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Fact Sheet 6

Work-Out Strategies for Delinquent Loans

Every loan officer will eventually face the challenge of managing a loan in serious trouble. The key to successful handling of this situation lies in swift and decisive action from the loan officer and the lending institution.

"**Work-out**" is a term used by microfinance practitioners to describe the steps taken to minimize or prevent financial loss to the institution when a loan is undeniably in trouble. Successful MFIs make work-out a top management priority. A loan officer must feel confident that by immediately reporting a delinquency in his portfolio, he engages a support system designed to get the situation back on track as quickly as possible.

WORK-OUT TECHNIQUES

Stage One -- "What's Going on with This Loan?"

No two problem loans are exactly alike; therefore work-out must be flexible and dynamic process. In the earliest stages of work-out, the loan officer and a management representative analyze information specific to the loan, including causal factors, extenuating circumstances and legal ramifications. Once these elements of the equation have been examined, a customized action plan is created.

The loan officer must be prepared to answer the following questions for management.

What is the nature of the problem? (missed payment, borrower failed to show up for monitoring appointment, inventory theft, fire, serious illness)

Are the loan documents and monitoring records in order and ready for review?

How is the borrower's relationship with the loan officer at present? (cooperative, hostile?)

What are the status and location of the loan collateral and/or loan guarantors?

Has the loan been graded appropriately using the Credit Risk Grading System?
(see Fact Sheet 5)

Gathering this key information prior to the first meeting will facilitate the rapid development of an action plan. Just as no two problem loans are alike, action plans will vary in accordance with the nature and the severity of the problem. The direct involvement of an experienced management representative is required to map out an appropriate course of action.

Stage Two - Communicating with the Borrower

Implementation of an action plan for a troubled loan begins with opening a frank dialogue with the borrower. The borrower must understand that the MFI considers the loan to be in trouble, and that it is prepared to initiate steps to protect its investment. At the same time, it is not usually helpful to intimidate or alienate the borrower. The borrower's cooperation will greatly improve chances for a successful work-out.

Here are a few illustrative questions that should be answered at the first work-out meeting with the borrower.

What is the borrower's explanation for the status of the loan?

What is the borrower's current cash flow situation?

What steps has the borrower taken to correct the problem?

When does the borrower anticipate that payments will resume?

Does the borrower understand that failure to repay the loan will result in the loss of credibility and will negatively affect his ability to borrow in the future?

An important factor to remember is that the lender must establish control of the situation immediately. The borrower cannot be permitted to dictate the course of action at this point. This is the responsibility of the lender. In many instances, the lender's rapid and well-prepared response, using the steps laid out in Stages 1 and 2 above, can successfully resolve a delinquency. But what if it doesn't? At this point, the MFI is faced with a potential financial loss, and more serious action is required.

Stage Three - "Non-Accrual and Write-Off"

Moving the Loan to "Non-Accrual" Status

When recovery of the loan principal is doubtful, loans are considered to be in "non-accrual" status. Non-accrual means that the loan principal is no longer considered to be an asset of the MFI. At this stage, the work-out team may consider various incentives may be employed to encourage eventual repayment, including restructuring of the loan terms or a rebate of interest paid. These strategies are often only marginally successful, and should only be implemented under the guidance and with the approval of management.

Engage Participation of Loan Guarantors

In Stage 3, the loan's guarantors must be called in to assist in collection efforts. In community-based microlending, peer pressure is a highly effective tool. Many borrowers consider loss of reputation more important than the loss of collateral. For this reason, loan officers should not hesitate to engage the participation of the loan's guarantors when a loan payment is delinquent

Fact Sheet 7

Microlending in an Islamic Environment

In recent years, economic development experts have praised microfinance operations in the West Bank and Gaza Strip for the depth of their outreach into the poorest communities. Blending modern microfinance best practices techniques with the principles of Islamic finance can help to further expand program outreach. In a region where more than 95% of the population is Muslim, many microlenders offer products designed specifically to accommodate the needs of the communities they serve.

Islamic Finance and Microlending are Compatible

Islamic scholars recognize that the provision of needed financial services to the working poor can be accomplished in a manner that is completely compatible with the precepts of Islamic law. The mutual goals of poverty alleviation and economic advancement for distressed communities form the basis of the harmonious relationship that exists between microfinance programs and Islamic religious law.

Islamic Financing Techniques

According to experts in Islamic finance, the restrictions set forth in the Koran on interest-based lending are specific in their intent to prohibit exploitation and usury. Microfinance practitioners in the West Bank and Gaza Strip and throughout the Islamic world offer credit and savings products to microentrepreneurs by incorporating mechanisms sanctioned by the Islamic financial system. The following definitions provide a summary of the Islamic financing techniques that are being applied to microfinance operations in the region.

MURABAHA (*cost plus markup*)
Murabaha is a common instrument used for short-term and long-term financing based on the conventional concept of purchase finance or cost plus markup sales. The seller reports to the buyer the cost of acquiring or producing a good, and then a profit margin is negotiated between the two parties. Payment is usually made in installments.

MUSHARAKA (*joint-venture or equity participation*)
Musharaka is an equity participation contract in which the MFI is not always the only provider of funds. The distinguishing features of this type of contract are the nature of the business activity and the duration of the gestation period for the business. Two or more partners contribute to the capital and expertise of an investment. Profits and losses are shared according to the amounts of capital invested.

This type of transaction has traditionally been used to finance medium and long-term investments. MFI's have the legal authority to participate in the management of the project. Each investor's rights correspond to their amount of equity capital in the enterprise.

MUDARABA (*partnership*)

Under a mudaraba contract, the MFI provides the capital needed for a project while the entrepreneur offers labor and expertise. The profits (or losses) from the project are shared between the MFI and the entrepreneur at a fixed ratio. These types of contracts are most common in investment projects in trade and commerce that are capable of achieving full operational status in a short period. Financial losses are assumed entirely by the MFI; the liability of the entrepreneur is limited to time and effort. In cases of proven negligence or mismanagement by the entrepreneur, however, they may be held responsible for the financial losses. Two types of mudaraba arrangements are:

> **Musaqat**: applies specifically to orchards, whereby the harvest is shared among all equity partners according to their contributions, and
>
> **Muzar'ah**: an agricultural arrangement whereby the funding party provides land or money in return for a share of the harvest.

QARD AL-HASANAH (*benevolent loan*)

Qard al-hasanah are loans with zero return that the Koran encourages Muslims to make to "those who need them". MFIs are allowed to charge a service fee to cover the administrative and transaction costs of these loans so long as costs are not related to the maturity or the amount of the loan.

IJARA WA IQTINA' (*leasing*)

Ijara wa iqtina' involves pure leasing (ijara) or lease purchase (ijara wa iqtina') transactions in which a party leases a specific product for a specific sum for a given period. In lease purchase arrangements, a portion of each payment is applied to the final purchase of the product, at which time ownership is transferred to the leaseholder.

BAI'MUA'JJAL, BAI'SALAM AND BAI' SALAF (*sales contracts*)

Bai'mua'jjal is an arrangement in which the seller of the product accepts deferred payments in installments or in a lump sum. Bai'salam and bai'salaf are similar to forward contracts, with the buyer paying the seller the fully negotiated price of a product that the seller promises to deliver at a future date.

JO'ALAH (*service charges*)

Jo'alah are service charges that usually occur during transactions of various services. They often occur when the buyer of a service agrees to pay the provider a specified fee according to a contract.

Source: Dhumale, R. and Sapacanin, A. "An Application of Islamic Banking Principles to Microfinance", World Bank, 1999.

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Fact Sheet 8 Microlending in a Distressed Economic Environment

Microfinance Lenders Operate in Different Environments

Successful microfinance programs throughout the world understand the social, economic and political environments in which they operate. Some microlending institutions do business in regions that are economically depressed, but relatively stable politically and socially. Others face the complexities of conducting operations in countries where legislation regulating the activities of the financial sector is still being established. Many microfinance institutions establish operations in regions devastated by natural disasters such as flooding or an earthquake, or in areas torn apart by war.

In each case, the local climate creates a specific set of conditions that affect borrower behavior. And while best practices relating to the mechanics of microlending are consistent in all environments, microfinance experts agree that successful programs carefully study the unique characteristics of the local community and create strategies to accommodate them.

Microlending in the West Bank and Gaza Strip

Currently, microfinance practitioners in the West Bank and Gaza Strip face a particularly intricate set of challenges. Mobility restrictions and intermittent curfews are realities of life. Yet the business community has proven remarkably resilient in the face of economic adversity, and strong community and family ties sustain order in civil society.

The Palestinian Network for Small and Micro Finance recognizes that the need for a flourishing microfinance industry in the West Bank and Gaza Strip has never been greater. Recent statistics indicate that current programs are reaching only 23% of potential borrowers. Lenders can expand operations with confidence if loan officers are trained to function in challenging conditions and to predict trends in borrower behavior.

Q & A

How can loan officers conduct monitoring visits when travel restrictions are in place? Recruiting loan officers from the local community is an effective way to avoid inter-city travel restrictions. Often, travel within population centers is unimpeded, even though travel between cities may be prohibited.

Is it possible to conduct monitoring operations in the event of military closures or curfew? Yes, to a large degree. Loan officers equipped with laptop computers, modems, faxes and telephones can function quite effectively even in areas under curfew. At a minimum, telephone contact with the borrower should be maintained. In many cases, clients may also have periodic access to faxes and home computers, which can be used to transmit financial data to the loan officer. It is extremely helpful for loan officers to discuss with the client the extent to which he/she has access to technological resources. Together, they can prepare an action plan to facilitate communication and the exchange of information in the event curfews are imposed.

What if a client misses a payment due to unanticipated restrictions on movements? Special exceptions must be made for missed payments that occur due to external circumstances entirely beyond the client's control. In these cases, telephone contact with the borrower should be made immediately and a new collection date established. By the same token, effective loan officers may suggest advancing a collection date if closure is anticipated, so long as it does not create undue hardship for the borrower.

What types of borrower behavior patterns can be expected in a distressed environment? Disruption of daily work routines due to political situations can contribute to a variety of predictable behavior patterns among borrowers. Locally-based loan officers must develop strategies to cope with them, as described below:

Irregular Work Schedules. When businesses are unable to open for several days, the loan officer should remain in frequent telephone contact with the borrower. Keeping open lines of communication helps both the loan officer and the client to adjust expectations and to set mutually agreeable deadlines based upon a realistic assessment of the situation.

Erosion of Sense of Purpose. Ongoing disruption of personal and business routines can create an atmosphere of malaise within a society. Loan officers can help business owners stay on track by maintaining a positive attitude and engaging the borrower in a proactive approach to solving difficulties. Conversations that focus on business strategy and future plans can help the borrower to maintain a sense of control and purpose.

Special Considerations for Delinquency. In an area where social ties are extremely strong, such as the West Bank and Gaza Strip, delinquent borrowers may attempt to pressure loan officers for leniency through mutual friends or family members. Loan officers should be carefully coached in the handling of these delicate situations.

- Remind the borrower that the MFI is providing an important service to the local community and that delinquent loans affect its ability to loan to others in need.
- Engage the support of loan guarantors or other trusted members of the business community in efforts to work with delinquent borrowers.
- Emphasize that current conditions will eventually improve; and that failure to honor loan obligations will hinder the client's ability to secure new loans in the future.
- Briefly explain to involved friends or family members the nature of the loan contract, and the importance of the borrower's commitment to the MFI.
- Network with other loan officers in the program to exchange ideas and share strategies that have proven successful in the local environment.

The scenarios detailed above are intended to illustrate a few of the behavior patterns that may emerge among borrowers during difficult times. Microfinance institutions have a responsibility to conduct business in a manner that is sensitive to prevailing conditions in the local community.

The Palestinian Network for Small and Micro Finance is committed to helping lenders in the West Bank and Gaza Strip build a microfinance infrastructure that provides stability, promotes sound business practices and builds the foundations for long-term economic growth.